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SUBJECT: UKRAINE: NBU GOVERNOR ON HIS WAY OUT?

REF: KYIV 155

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¶1. (SBU) Summary. National Bank of Ukraine (NBU) Governor Volodymyr Stelmakh may be on his way out. In a legally meaningless yet politically important move, the Rada voted to oust Stelmakh on January 26. The Rada's actions have incited a fresh round of accusations between Prime Minister Yulia Tymoshenko and President Viktor Yushchenko, in what amounts to the latest proxy dispute over leadership and responsibility for Ukraine's deteriorating economic crisis (reftel). Stelmakh is being criticized for his heavy-handed, insular, and uncooperative leadership style and for the NBU's botched foreign exchange interventions. Under Stelmakh, the NBU has also been accused of favoritism in both the foreign exchange market and in the refinancing of banks. Yushchenko continues to stand by Stelmakh, but the pressure to oust the unpopular governor is growing, and now Yushchenko must decide whether to abandon his fallen ally or stand-by Stelmakh and risk further culpability for the NBU's blunders. End summary.

Stelmakh Under Pressure

¶2. (SBU) NBU Governor Volodymyr Stelmakh is coming under increasing pressure and may resign or be fired soon. Stelmakh, who is close to President Yushchenko, has been on vacation since early January, a step that makes little sense in the midst of Ukraine's worsening economic crisis but is commonly taken by leading Ukrainian officials shortly before their ouster. Currently, First Deputy Governor Anatoliy Shapovalov is acting head of the NBU, but we hear repeatedly that important decisions are not being taken on account of Stelmakh's absence.

IMF: Stalemate "Can't Go On"

¶3. (SBU) IMF mission chief Ceyla Pazarbasioglu told us on January 27 that the current stalemate between Tymoshenko and Yushchenko over Stelmakh's fate "can't go on (any longer)." Pazarbasioglu and her deputies, in Kyiv to monitor progress on Ukraine's \$16.4 billion Stand-By Arrangement, could not say for certain that there would be a move at the central bank. Citing politically charged conversations held with Tymoshenko and Presidential aides, however, IMF senior expert Thordur Olafsson indicated his impression that there would likely be a new NBU Governor in coming days, since "nobody seems to trust (the NBU) now." Separately, EBRD officials told us on January 28 that the NBU had become "paralyzed" over the Stelmakh affair, with decisions on key banking reforms delayed by a lack of leadership.

Rada Action Unconstitutional

14. (SBU) In a special January 26 session of the Verkhovna Rada, Tymoshenko's BYuT faction teamed up with the Communist Party to narrowly pass a resolution that cancels the 2004 Rada confirmation of Stelmakh. The move has no legal significance, however. According to the Ukrainian constitution, the Rada approves the President's nomination and dismissal of the NBU governor. It has no power to dismiss the NBU governor on its own. Tymoshenko told a live television audience that the Rada's method for removing Stelmakh was not "natural" but nonetheless the "only legal means" to restore confidence in the currency and financial markets. "

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.RHLNXEMNUkrainian commentators disagree, suggesting that the Rada's attempt to oust Stelmakh fell outside its legal writ. President of the Ukrainian Academy of Political Science Nikolay Mikhalchenko noted that ""
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oskhh `~kl p", - `g`k .parliament is not acting in the spirit of the law." Yuriy Yakimenko of the Ukrainian Center for Economic and Political Studies likewise stated that the Rada decision did not respect the President's constitutional authority and would cause the matter to be taken up in Constitutional Court.

15. (SBU) According to these experts, Stelmakh will remain the nominal NBU governor until his five-year term expires in December 2009, unless he resigns or is fired by Yushchenko, with subsequent Rada approval. Yushchenko's public statements continue to support the wounded Governor. Appearing on television Kanal 5, owned by Yushchenko ally and National Bank council chairman Petro Poroshenko, the President said that he would appeal to the Constitutional Court

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against the Rada's decision, in order to "safeguard the NBU" from political forces in the Cabinet. The President is not challenging the substance of the Rada action, which has no legal implications, but instead hopes to get a ruling to block the Rada from taking such actions in the future.

16. (SBU) Rada deputy and former NBU Governor Sergey Tigipko is widely viewed as a favorite to replace Stelmakh if he is in fact dismissed. After its meaningless January 26 vote, the Rada failed by a few votes to reinstate Tigipko. It is also being speculated that First Deputy Governor Shapovalov could remain as Acting Governor until a new president is elected in late 2009 or early 2010.

17. (SBU) Stelmakh has been a favorite whipping boy since September 2008, when Ukraine's currency began its steep decline against the dollar. The NBU has been criticized for its poor management of the hryvnia devaluation, having spent roughly \$11 billion in reserves, mostly through ineffective and non-transparent efforts to stabilize the currency, which has lost almost half its value in recent months. Stelmakh has also been criticized for an inflexible and secretive management style, and he has been at odds with both Tymoshenko and the Ministry of Finance on a nearly uninterrupted basis since the crisis began. The NBU has also been accused of favoritism in its foreign exchange interventions and its refinancing of banks. In both instances, the NBU's actions have often been non-transparent and sometimes unexplainable, perhaps favoring particular insiders at the expense of the broader market. According to media reports, the NBU has sold nearly \$1 billion in January to prop up the currency, while macroeconomists tell us Ukraine's current account deficit should cause the hryvnia to devalue another 15-25 percent.

18. (SBU) Comment. .RHLNXEMN g`hk`,

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has shrouded her faction's vote to dismiss Stelmakh in economic terms by suggesting that a new NBU Governor could restore the hryvnia to an improbable 6-6.5/\$ rate (last seen in the first weeks of the crisis). Yet, her ulterior motive is equally clear and certainly politically driven. Having pushed Yushchenko into a corner, from which he must alienate his longtime friend and former

NBU colleague or associate himself with the ill-fated policies of the NBU, Tymoshenko looks to further tarnish her rivals' reputation and highlight his political weaknesses amidst a sharpening crisis. The presence of the IMF team may have emboldened Tymoshenko; it also puts pressure on the President to act, since the lack of an NBU decision-maker on banking sector reforms has been a chief concern of the IMF team thus far. End comment.

TAYLOR